

1991

Board of Equalization of Salt Lake County, State of Utah v. Sinclair Oil Corporation, d/b/a Little America Hotel Company; and Utah State Tax Commission : Brief of Appellant

Utah Supreme Court

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David E. Yocom; Salt Lake County Attorney; By: Mary Ellen Sloan; Deputy County Attorney; Bill Thomas Peters; Special Deputy Salt Lake County Attorney; Attorneys for Appellant.

Louis H. Callister; Dorothy Plesche; Callister, Duncan & Nebeker; Attorneys for Respondent.

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DOCKET NO.

STATE SUPREME COURT

BRIEF

910050

IN THE SUPREME COURT OF THE STATE OF UTAH

BOARD OF EQUALIZATION OF
SALT LAKE COUNTY, STATE OF
UTAH,

Appellant,

-v-

SINCLAIR OIL CORPORATION,
d/b/a LITTLE AMERICA HOTEL
COMPANY; and UTAH STATE TAX
COMMISSION,

Respondents.

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Docket No. 910050

State Tax Commission
Appeal No. 89-0536

Account No. 15-01-477-001

AMENDED BRIEF
OF APPELLANT BOARD OF EQUALIZATION
OF SALT LAKE COUNTY

Little America Hotel
c/o Louis Callister
Dorothy Plesche
CALLISTER, DUNCAN & NEBEKER
Suite 800 Kennecott Building
Salt Lake City, Utah 84133

Attorney for Respondent

DAVID E. YOCOM
Salt Lake County Attorney
By: MARY ELLEN SLOAN (2980)
Deputy County Attorney
Attorney for Salt Lake County
2001 South State Street #S3600
Salt Lake City, Utah 84190-1200
Telephone: (801) 468-2652

BILL THOMAS PETERS
Special Deputy Salt Lake County
Attorney
9 Exchange Place #400
Salt Lake City, Utah 84111
Telephone: (801) 364-8644

Attorneys for Appellant

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CLERK SUPREME COURT,
UTAH

IN THE SUPREME COURT OF THE STATE OF UTAH

BOARD OF EQUALIZATION OF
SALT LAKE COUNTY, STATE OF
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Little America Hotel
c/o Louis Callister
Dorothy Plesche
CALLISTER, DUNCAN & NEBEKER
Suite 800 Kennecott Building
Salt Lake City, Utah 84133

Attorney for Respondent

DAVID E. YOCOM
Salt Lake County Attorney
By: MARY ELLEN SLOAN (2980)
Deputy County Attorney
Attorney for Salt Lake County
2001 South State Street #S3600
Salt Lake City, Utah 84190-1200
Telephone: (801) 468-2652

BILL THOMAS PETERS
Special Deputy Salt Lake County
Attorney
9 Exchange Place #400
Salt Lake City, Utah 84111
Telephone: (801) 364-8644

Attorneys for Appellant

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Appellant, Board of Equalization of Salt Lake County, by and through its attorneys, Mary Ellen Sloan, Deputy Salt Lake County Attorney, and Bill Thomas Peters, Special Deputy Salt Lake County Attorney, submits the following brief.

STATEMENT OF JURISDICTION

Jurisdiction of this matter rests with the Supreme Court pursuant to §63-46(b)-16, Utah Code Ann., (1988), and Rule 14 of the Utah Rules of Appellate Procedure for Review of Agency Action.

STATEMENT OF ISSUES PRESENTED FOR REVIEW

The issues presented by this petition are whether, based on all of the evidence in support of the Tax Commission's findings, the Tax Commission's findings of fact as to the Room Departmental Expense Category of the subject property, Little America Hotel, Parcel No. 15-01-477-001, are supported by substantial evidence and/or whether the Tax Commission has decided all issues requiring resolution.

STATUTES

Statutes, the interpretation of which may be determinative, are §36-46(b)-16(4)(c) and (g), Utah Code (1988), set forth in paragraph 16 here,

(4) The appellate court shall grant relief only if, on the basis of the agency's record, it determines that a person seeking judicial review has been substantially prejudiced by any of the following:

* * *

(c) the agency has not decided all of the issues requiring resolution;

* * *

(g) the agency action is based upon a determination of fact, made or implied by the agency, that is not supported by substantial evidence when viewed in light of the whole record before the court;

STATEMENT OF THE CASE

1. On or about the 21st day of April, 1989, respondent Sinclair Oil Company, d/b/a Little America Hotel Company, appealed from a decision of the Salt Lake County Board of Equalization to the Utah State Tax Commission regarding the 1988 property value placed on the subject property, parcel No. 15-01-477-001, known as Little America Hotel and related facilities. Said property is located in Salt Lake City, Utah, between Main Street and West Temple and between 5th South and 6th South Streets. An Amended Notice of Appeal was filed on August 29, 1989.

2. On the 13th of April, 1990, after a trial in the matter conducted on December 12, 13, and 14, 1989, the Utah

State Tax Commission (hereinafter "Commission") entered Findings of Fact, Conclusions of Law, and Decision.

3. On the 3rd day of May, 1990, Salt Lake County filed a Petition for a Reconsideration and Memorandum in support thereof. A hearing was held August 14, 1990. On the 7th day of January, 1991, the Commission denied the Petition for Reconsideration, and entered an order.

4. An appeal was taken by the petitioner seeking a review of the Final Decision and of the denial of the Petition for Reconsideration. The Petition for Review of Agency Action was filed on February 6, 1991. The petition addresses one factual dispute before the Commission i.e., the Room's Departmental Expense Category.

5. Although the Commission denied the petition, it did include in its order its determination of the three expense categories noted in the Petition for Reconsideration. As to the Room's Departmental Expense, it utilized the actual expenses of Little America.

STATEMENT OF FACTS

1. At the hearing before the Commission on the 1988 valuation of the Little America Hotel property, certain evidence was introduced by the parties relating to the Room's Departmental Expense Category.

2. Little America Hotel Company, (hereinafter "Little America"), submitted a "Real Estate Tax Protest" prepared by

James W. Hire (hereinafter "Hire"), its expert witness in support of its assertion of value of the property. Trial Exhibit P-11.

3. Hire made the following analysis of the Rooms Departmental Expense item:

"Little America operates at a higher expense ratio in the Rooms Department than industry averages. Our projections decrease this expense ratio substantially. The dollar decrease in costs in the first year alone is over \$700,000. This reflects a higher profit to a new owner.

Trial Exhibit, P-11, p.16; Trial Transcript, Vol. 1, p. 152, Vol. 2, p. 221.

4. Hire included an estimated annual operating statement attached to his report. Trial Exhibit P-12. This statement reflects his reduction of Little America's actual expense for the Rooms Departmental Expense Category (hereinafter "RDE"), in 1988 from \$4,160,000 to \$3,456,000; which reflects \$700,000 excess in the expense category when compared to industry averages. This reduction reflected a decrease of approximately 28% in this expense category. Trial Exhibit R-1, p.2; Trial Exhibit P-11, p.16-17. Hire testified that Little America's actual RDE Category included several items but did not mention the Room's Repair and Maintenance Expense (hereinafter "RRM"). Trial Transcript, Vol. 1, p. 179.

5. Hire added a 2% or \$444,000 Reserves for Replacement Expense Category. Trial Exhibit P-12; Little

America's actual operating statement did not include a Reserves for Replacement Expense Category. Trial Transcript, Vol. 1, p. 155; Vol. 2, p. 227. Hire testified that the repairs were made on an as needed basis as a capital replacement and not as an expense. Trial Transcript, Vol. 1, p. 155; Vol. 3, p. 443. Ken Knight, Vice President of Sinclair Oil confirmed this method of accounting for capital expenditures. Trial Transcript, Vol. 3, p. 468.

6. Salt Lake County's expert witness, David W. Evans, Jr., (hereinafter "Evans"), Salt Lake County Assessor's Office, developed an operating statement utilizing Little America's actual operating expenses, except as noted, including Little America's actual expense of \$4,160,000 in the RDE Category.

7. Although utilizing Little America's actual operating statement, Evans considered two other customary expense categories in the income approach to valuation which were not included in Little America's actual operating statement, i.e., Franchise Fees and Reserves for Replacement. Trial Exhibit R-3, page 54.

8. Relying on Rushmore on Hotel Valuation 1989 and an industry publication, Trends in the Hotel Industry, published by Pennell Kerr Forster, Evans added a three percent Franchise Fee or \$673,143 to the estimated operating statement. Trial Exhibit R-3, p. 54. Franchise Fees were not an "actual expense" of Little America but were included by both experts in

determining value. Trial Exhibit P-12; Trial Transcript, Vol. 1, p. 154.

9. The other expense category considered by Evans was Reserves for Replacement. He determined that the typical Reserve for Replacement accounts allow between 2% and 4% deduction for this expense. He determined that the Reserve for Replacement Expense was "more than compensated for" in the Rooms Departmental Expense and other Operated Departments Expense since these expenses were higher than typical. Trial Exhibit R-3, p. 51-52, 54; Trial Transcript, Vol. 3, p. 417. At the same time he did not reduce the Room's Departmental Expense or Other Operating Expense Categories to industry averages. Trial Exhibit R-3, pp. 51-52, 54; Estimated Operating Statement. In Evans' appraisal, it is stated as follows:

"Reserves for replacement: In discussions with the subject's management, they indicated that no plan in which they repaired or replaced real or personal property on a continuing pre-planned schedule, was in place. Rather, they performed these repairs and replacements on an as needed basis. This would account for a higher than typical operating expense in both the Rooms Expense Category, and for the higher expense in the other operated departments. While the typical reserve replacement accounts allow for between 2% and 4% deduction of expenses, it is believed that these expenses are more than compensated for in the two aforementioned expense categories.

Trial Exhibit R-3, p. 54.

10. George Christopulos, Salt Lake County Appraiser, (hereinafter "Christopulos"), submitted an analysis of the Hire report. Trial Exhibit R-1. Christopulos reported that Little America's actual Room's Departmental Expense category included \$801,000 for Rooms Repairs and Maintenance (hereinafter "RRM"). He reported obtaining this information from Terry Whipple, Director of Tax Administration for Little America, who compiled the operating statements for Little America. Christopulos further reported that Trends in the Hotel Industry, Id., does not include RRM expenses in the RDE Category. Christopulos reported that RRM expenses are customarily accounted for in the Property Operation and Maintenance category (hereinafter "POM"). Trial Transcript, Vol. 2, p. 251-252. Christopulos further testified that once RRM expenses and property taxes allocated to the RDE Category are subtracted, the RDE Category equals \$3,286,000, which is about the industry average. Trial Transcript, Vol. 2, p. 254.

11. Other expense items were added to the estimated operating statement by both Evans and Hire. Trial Exhibits P-11; R-3. A Management Fee Expense of \$425,000 was added to the estimated operating statement; this fee was not an "actual expense" of Little America. Trial Transcript, Vol. 2, p. 224-225. The \$425,000 was an estimated expense. Trial Transcript, Vol. 2, p. 225.

12. The Commission in its order denying the Petition for Reconsideration made the following finding regarding the Room's Departmental Expense:

"The Commission used the actual Room's Departmental Expense. Therefore, any changes in future years should be considered in future calculations of fair market value of the property."

In its Final Decision, the Commission stated:

"Therefore, for purposes of this proceeding, the Commission has utilized the actual operating experience of Little America as was suggested by the witnesses for Salt Lake County."

13. Both valuation witnesses and Christopulos relied in their analysis of the property on hotel industry publications, particularly those published by Pannell Kerr Forster. Trial Exhibits R-3, R-1, P-11. Trends measures occupancy and average room rates and individual markets nationwide, including the State of Utah and in Salt Lake. National Trends is an annual publication which is a compilation of operating results from hotels in a common format. They are highly regarded and well related to as industry averages. Trial Transcript, Vol. 1, p. 98-99.

ARGUMENT

POINT I.

STANDARD OF REVIEW

The Administrative Procedures Act, Utah Code Ann.

§63-46(b)-1 through 22, governs this court's review of the Tax Commission's proceedings.

In First National Bank of Boston v. County Board of Equalization, 799 F.2d 1163 (Ut. 1990), this court elaborated upon the standard of review set forth in §63-46(b)-16(4)(g) as follows:

"It requires an appellate court to review the 'whole' record to determine whether the agency's action is 'supported by substantial evidence' is that quantum and quality of relevant evidence that is adequate to convince a reasonable mind to support a conclusion. An appellate court applying this 'substantial evidence test' must consider both the evidence that supports the tax commission's findings and the evidence that detracts from the findings. Nevertheless, the party challenging the findings -- in this case, the taxpayer -- must marshal all of the evidence supporting the findings and show that despite the supporting findings, the tax commission's findings are not supported by substantial evidence." [citations omitted].

799 P.2d at 1165

POINT II.

UTILIZATION OF "ACTUAL EXPENSES" FOR
THE ROOM'S DEPARTMENTAL EXPENSE
CATEGORY IS NOT SUPPORTED BY
SUBSTANTIAL EVIDENCE.

There are three approaches to determining fair market value: the income approach; the cost approach and the comparative sales approach. Trial Transcript, Vol. 1, p. 104-105. Salt Lake County utilized all three approaches. Trial Exhibit R-3. Little America utilized the income approach. Trial Exhibit P-11. The Tax Commission adopted the income approach. The income approach is based on the capitalization of the net operating income and/or a discounted cash flow analysis, which equates future cash flows with present value. Trial Exhibit R-3, p.7. The income approach included an analysis of expenses compared with those put forth in the Trends publication.

The expense categories compared by Evans are as follows:

UNDER DEPARTMENTAL COSTS AND EXPENSES:

- Rooms Expenses
- Food & Beverage Expenses
- Telephone Expenses
- Other Operated Departments Expenses

UNDER UNDISTRIBUTED OPERATING EXPENSES:

- General & Administrative Expenses
- Management Fees
- Marketing Expenses
- Property Maintenance Expenses
- Energy Costs

UNDER PROPERTY TAXES AND INSURANCE EXPENSES:

- Property Taxes
- Insurance

Trial Exhibit R-3, p.49.

The evidence presented to the Commission on the Room's Departmental Expense (hereinafter "RDE"), is that Little America's actual expense exceeded national industry averages. Evans, Trial Exhibit R-3, p. 54; Hire, Trial Exhibit P-11, p. 16. Both experts accounted for this excess and made adjustments to the operating statement to reflect the excess. Christopulos corroborated the existence of the excess expenses in the RDE Category and identified it as Rooms Repair and Maintenance Expenses. Trial Exhibit R-1, p. 2.

Hire adjusted his operating statement by reducing the RDE Category by \$700,000, and treated the reduction as profit to the new owner. Trial Exhibit P-11, p. 16. Evans treated the excess expenses as Reserves for Replacements. Trial Exhibit R-3, p. 54. Both experts concurred that Reserves for Replacement type expenses were paid for on an as needed basis. Trial Exhibit R-3, p. 54; Trial Transcript, Vol. 1, p. 155. Evans recognized the excess expenses in both the RDE Category and Other Operating Expense Category, but did not adjust either category downward. Instead Evans accounted for this excess by not adding a Reserves for Replacement Expense Category. He believed that the higher than average expenses in the foregoing two categories more than compensated for the lack of Reserves for Replacement as an expense item. Thus, both experts adjusted or accounted for the excess in the RDE Category, but the Tax Commission did not.

Christopulos' testimony corroborates the existence of excess expenses in the RDE Category noted by Hire and Evans. Christopulos testified that approximately \$800,000 for 1988 in the RDE Category was comprised of an expense item known as Rooms Repair and Maintenance (hereinafter "RRM"). Terry Whipple, Tax Director for Little America, so advised him. Trial Exhibit R-1, p. 2; Trial Transcript, Vol. 2, p. 251-252. Christopulos' report stated that the RRM Expense is not typically included in the RDE Category. Rather, the hotel industry places the RRM Expenses in the category of Property Operation and Maintenance (hereinafter "POM"). But the actual POM Expense Category of \$915,000 - \$929,000 utilized by Evans and Hire, respectively, was at about the industry level for hotels of this size and room rate. Trial Exhibit R-3, p. 53. Christopulos concluded the RRM expenses were actually akin to or included Reserves for Replacement. Trial Transcript Vol 2, p. 252, 259. According to Christopulos, by subtracting the RRM Expense from the RDE Category, it left the RDE Category at about the industry average. Trial Exhibit R-1, p.3.

Based on all of the evidence produced by both parties at trial, including both expert witnesses on property valuation and Christopulos' testimony drawn from information from Little America and industry averages, the Commission's findings as to the RDE Category are not supported by substantial evidence. The Commission incorrectly used actual expenses for this category.

Actual expenses weren't used by the Commission in all instances. For example, Little America's actual operating statement did not include three industry accepted expense categories: Franchise Fees, Management Fees and Reserves for Replacement. The Commission included all three in the estimated operating statement, based upon the testimony of both expert witnesses. Since it did not use "actual expenses" in all instances but adjusted for industry averages such as adding a Franchise Fee and Reserves for Replacement, the Commission should have adjusted the RDE category on the estimated operating statement based on industry averages to reflect either the adjustment made by Hire (reducing the expense by \$700,000 and treating it as profit) or by accounting for the excess as a Reserves for Replacement Expense as did Evans and Christopulos. Since the Commission has already added \$444,000 as a Reserves for Replacement, the foregoing excess should be subtracted from the overall expenses.

In First National Bank of Boston v. Salt Lake County Board of Equalization, 799 P.2d 1163 (Ut. 1990), both parties to the litigation introduced evidence as to the expense ratio to be utilized in valuing the property under the income approach. Both parties introduced evidence of expense ratios higher than the 25% figure ultimately used by the Commission. The Commission did not make findings as to its basis for using the 25% figure.

The court held that the "agency's decision must rest upon some sound evidentiary basis, not a creation of fiat," Id. at 1166, and remanded the matter to the Commission for further proceedings. In this instance, where all of the witnesses adjusted or accounted for the excess expenses in the RDE Category, the Commission's blanket reliance on use of "actual expenses" for the RDE category does not rest on a sound evidentiary basis. Further, the Commission did not act consistently in the treatment of expenses. It used actual expenses in some instances. In others, if Little America did not incur an actual expense in a particular category, the Commission added expense categories; i.e., Franchise Fees, Reserves for Replacement and Management Fees, consistent with industry standards.

POINT III.

THE TAX COMMISSION FAILED TO MAKE FINDINGS OF FACT IN SUFFICIENT DETAIL.

The Commission has utilized "actual expenses" of Little America in the RDE Category. Although all of the evidence introduced was that this expense category exceeded the industry averages of hotels of this type and that both expert witnesses on the matter of valuation made adjustments to this expense category, the Tax Commission did not. By failing to make factual findings as to the conflict in the expense item;

i.e., excess profit, Reserves for Replacement and/or Room's Repair and Maintenance, the Commission did not decide all issues that require resolution. Since the Commission added a Reserves for Replacement of \$444,000, (which Salt Lake County does not contest is in error), it should have made findings as to the excess expenses reflected in the RDE Category as evidenced by all of the expert witnesses, Hire, Evans and Christopulos.

Those excess expenses were estimated to run anywhere from \$700,000, as determined by Hire, to \$800,000, as determined by Christopulos, based on information received from Little America, and on the industry averages for hotels of this size and room rate. By failing to make a determination of these facts, the Commission failed to make findings of fact on all necessary "ultimate issues or has failed to make subsidiary findings in sufficient detail that the critical subordinate factual issues are highlighted and resolved." Milne Truck Lines, Inc. v. Public Service Commission of Utah, 720 P.2d 1373, 1378 (Ut. 1986).

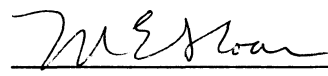
CONCLUSION

Based on the foregoing, when the record is examined as a whole, it supports a finding which reduces the Room's Departmental Expense from \$700,000 (Hire) to \$800,000 (Christopolis). Alternatively, the court should remand with an

order to enter findings regarding the issue of whether excess expenses exist in the RDE Category and whether the 1988 value of the property should be adjusted.

RESPECTFULLY SUBMITTED this 2nd day of July, 1991.

DAVID E. YOCOM
Salt Lake County Attorney



MARY ELLEN SLOAN
Deputy County Attorney
BILL THOMAS PETERS
Special Deputy Salt Lake County
Attorney
Attorneys for Salt Lake County

jp/851+

CERTIFICATE OF MAILING

I hereby certify on the 2 day of July, 1991, ten (10) true and correct copies of the foregoing were filed with the Supreme Court Clerk, and four (4) true and correct copies were mailed to the following:

Little America Hotel
c/o Louis Callister
Dorothy Plesche
CALLISTER, DUNCAN & NEBEKER
Suite 800 Kennecott Building
Salt Lake City, Utah 84133

Utah State Tax Commission
Heber Wells Building
160 East 300 South
Salt Lake City, Utah 84110

R. Paul Van Dam
Utah Attorney General
236 State Capitol Building
Salt Lake City, Utah 84114

Mrs. Joan